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Netherlands

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Overview of corporate tax income tax developments

After several years in which the Dutch government has made significant amendments to the corporate income tax rules aimed at combating undesirable deduction of interest expenses incurred by Dutch companies, it is expected that the Dutch corporate income tax rules will not change substantially in the coming years. As part of the aforementioned amendments, as from 1 January 2013, the Netherlands no longer applies thin capitalisation rules.

The Netherlands remains a very attractive jurisdiction for holding, finance and licence companies due to, for instance:

1. the significant number of bilateral tax and investment treaties;
2. the absence of the levy of withholding taxes on interest and royalty payments by Dutch companies;
3. the stable political situation; and
4. the broad scope of the participation exemption, which is one of the most important and historic pillars of the favourable Dutch investment climate.

In addition to the above it is noted that the "substance" of holding, finance and licence companies has (and will likely) become more important as a result of certain measures introduced by the Netherlands in connection with the pending international discussions regarding Base Erosion and Profit Shifting ("BEPS").

Another significant trend that we recognise in practice regards the in- and outbound cross-border conversions of international holding and finance companies within the EU (e.g. the cross-border conversion of Cypriot companies into Dutch companies). These conversions are mainly initiated by non-Dutch international operating groups in order to avoid the adverse application of new, less beneficial tax treaties, or to reduce the negative impact of new legalisation in their countries of residence. The increase of such cross-border conversions originates from a ruling of the European Court of Justice of 12 July 2012 (the VALE-case; C-378/10).

Significant deals and highlights illustrating aspects of corporate tax

In February 2014, Vodafone disposed of its 45% interest in the joint venture with Verizon Wireless. The size of the deal amounted to US$ 129bn and is considered the second largest in world history. The deal was performed by a Dutch subsidiary of Vodafone which held the stake in Verizon, and resulted in a US tax liability of US$ 5bn. The capital gain received by the Dutch subsidiary of Vodafone was fully exempt for Dutch corporate income tax purposes under the application of the Dutch participation exemption. Although the deal should not be considered unusual from a Dutch tax perspective, the relatively limited amount of taxation attracted the attention of the international media and the general public.

In February 2014, another significant deal was closed. The Italian oil company ENI International sold its 60% interest in Arctic Russia B.V. to Yamal Development against US$ 2.94bn. Yamal Development is a joint venture between the Russian oil and gas companies Novatek and GazpromNeft. Arctic Russia B.V. holds a 49% interest in Severenergia, a company exploiting four exploration and production concessions in the Yamal Nenets region in Siberia. This deal may function as an example for investors in the CIS region which frequently use the Netherlands as a holding jurisdiction. The reasons for such investors holding their investments through the Netherlands include the beneficial tax treaties and bilateral investment treaties concluded by the Netherlands with its treaty partners.

In September 2013, the US-based chip equipment manufacturer Applied Materials and its industry peer, the Japan-based Tokyo Electro, announced a merger of equals performed through a share-for-share merger with a value of US$ 9.4bn. The new top holding company will be resident in the Netherlands. The merger can be considered as an example for multinational companies considering the Netherlands as a preferable jurisdiction for their joint venture companies or merged companies. The reasons for such companies choosing the Netherlands include its international neutrality, the competitive tax climate and the high-level juridical infrastructure.

Key developments in jurisdiction affecting tax law and practice

General

The political and media debate concerning the use of what is referred to as "letterbox companies", thereby aiming at the alleged inappropriate use of Dutch holding, finance and licence companies in international tax structuring, is still pending. Although a certain political pressure exists to introduce measures taking away or reducing the attractive position of the Netherlands in international holding, finance and licence structures, the Dutch government has clearly taken the position that the favourable Dutch holding, finance and licensing regime is fully compatible with all international standards and that at present it has no intention of initiating any significant changes to this regime. The Dutch State Secretary of Finance has indicated that the Netherlands will follow and actively participate in the pending discussions at EU, OECD and G20 level. If these discussions do require the present tax regime to be amended, the Dutch government has indicated that it is prepared to do so in principle. Nevertheless, in anticipation of such international measures, the Dutch State Secretary of Finance recently introduced certain measures to promote transparency and prevent the unintended use of Dutch tax treaties. These measures will be described in the following two paragraphs.

Information requirements for intra-group licensing and financing companies

As per 1 January 2014, an increased information obligation applies to Dutch companies that primarily (i.e. for at least 70%) carry out intra-group financing and/or licensing activities ("Dutch group financing/licensing companies") if certain minimum substance requirements are not met. These substance requirements are almost identical to the minimum substance requirements that had to be met by Dutch group financing/licensing companies in order (i) to be able to obtain a ruling (i.e. an Advance Pricing Agreement or "APA"), and (ii) to avoid a spontaneous exchange of information by the Dutch tax authorities to the relevant foreign tax authorities. The increased information obligation is one of the measures to prevent the unintended use of Dutch tax treaties, as announced by the Dutch State Secretary of Finance in his letter of 30 August 2013. If the Dutch group financing/licensing company does not meet the minimum substance requirements, it should actively provide to the Dutch tax authorities:

1. an overview of which substance requirements are not met;
2. all necessary information to enable the Dutch tax authorities to determine which of the substance requirements are met;
3. an overview of all interest, royalty and similar payments for which the Dutch company has or could have claimed a reduction of (withholding) tax under a tax treaty or EU Directive; and
4. the names and addresses of the entities from which interest, royalty and similar payments as described under (3) above have been received.

The Dutch tax authorities will spontaneously exchange the above information with the relevant foreign tax authorities, which may use this information to determine whether or not the Dutch company is entitled to the reduced (withholding) tax rates on interest and royalty payments under the application of a tax treaty or a domestic rule. If the above information is not or not timely provided, an administrative penalty up to an amount of €19,500 may be imposed.

<u>Other measures to avoid abuse of tax treaties</u>

In addition to the above-described increased information obligation for Dutch group financing/licensing companies, the following measures have been taken to promote transparency and prevent the unintended use of Dutch tax treaties:

1. requests for an Advance Tax Ruling ("ATR") or an Advance Pricing Agreement ("APA") will only be taken into consideration by the Dutch tax authorities if the Dutch company meets certain minimum substance requirements or if there is sufficient (economic) nexus with the Netherlands;
2. the Dutch tax authorities intend to automatically exchange information regarding an APA with the relevant foreign tax authorities if the group of which the Dutch company is part does not have (or plans for) other activities in the Netherlands besides receiving and paying interest and/or royalties through the Dutch company; and
3. the Netherlands will propose to include anti-abuse rules in its (existing and new) tax treaties with developing countries.

The above first two measures have been laid down in the recently updated Decrees on ATRs, APAs and substance requirements. These Decrees apply as per 13 June 2014. However, in practice, certain elements already apply as of 1 January 2014.

<u>New Transfer Pricing Decree</u>

In November 2013, the Dutch Ministry of Finance published a new Transfer Pricing Decree. The new Decree seeks to clarify the application of the arm's length principle for situations which are not discussed in the OECD Model Convention, and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, or where this Convention and Guidelines are unclear. The new Decree became effective on 27 November 2013 and replaces earlier Decrees of 2001 and 2004.

Key developments in legislation affecting tax law and practice

<u>New legislative proposal regarding the participation exemption</u>

A Bill that provides the legal ground for the so-called "compartmentalisation regime" in relation to the Dutch participation exemption is under discussion in Dutch Parliament. In brief, the contents of this Bill can be described as follows.

Under the Dutch participation exemption, benefits (i.e. dividends, capital gains and liquidation proceeds) derived from a qualifying participation are exempt from Dutch corporate income tax, whereas losses generally are not tax deductible (except for liquidation losses).

Based on a judgment of the Dutch Supreme Court, in cases where a capital gain or liquidation proceeds originate from a period in which the participation did not qualify, as well as from a period in which the participation did qualify under the participation exemption rules (due to a change of the facts and circumstances), the gain/proceeds have to be apportioned to the period during which the participation did not qualify and to the period during which the participation did qualify. Only this last part of the gain/proceeds is then tax exempt. This principle is referred to as the so-called "compartmentalisation regime". With that it should be noted that the Dutch authorities are of the opinion that the compartmentalisation regime can also be applied to dividend distributions, however, this has not yet been confirmed in case law.

On 14 June 2013, the Dutch Supreme Court ruled that the above compartmentalisation regime does not apply with respect to the change in the application of the Dutch participation exemption as a result of the legislative change in these rules as per 1 January 2007.

In response to the decision of 14 June 2013, the Dutch Parliament has issued a Bill that will provide for application of the compartmentalisation regime in relation to the participation exemption in case of a change in law as well as in case of a change of facts and circumstances. Furthermore, it is proposed that the compartmentalisation regime should also be applied to dividend distributions (an exception may apply to dividends received from a qualifying EU company). If the Bill is adopted by the Dutch Parliament, it will become effective with retroactive effect from 14 June 2013.

Key developments in case law affecting tax law and practice

Landmark decisions of Dutch Supreme Court on hybrid financing instruments

On 7 February 2014, the Supreme Court of the Netherlands issued two landmark decisions on whether Dutch cumulative preference shares ("CPS") and Australian redeemable preference shares ("RPS") can be treated as debt for Dutch tax purposes. Based on these decisions, financial instruments (like CPS and RPS) that qualify as equity under Dutch corporate law also qualify as equity for Dutch tax purposes and cannot be reclassified into debt. Since CPS and RPS qualify as equity under Dutch corporate law, these shares should also qualify as equity for Dutch tax purposes. As a consequence, any income derived from the CPS and RPS falls under the scope of the Dutch participation exemption, provided that the conditions of this exemption are met. Please note that no exception is made in case of hybrid mismatches (i.e. the payments on the RPS were tax-deductible in Australia). The Dutch Supreme Court furthermore ruled that a refinancing of debt (i.e. a loan) into equity (i.e. preference shares) should not be considered abusive, since taxpayers are free to choose the manner of financing a subsidiary.

European Tax Law – Fiscal unity regime

For Dutch corporate income tax purposes, a fiscal unity can be formed between Dutch resident companies and non-Dutch resident companies having a permanent establishment in the Netherlands, if the parent company directly owns (legally and economically) at least

95% of the nominal paid-up share capital of the subsidiary and certain other conditions are met. Recently, the ECJ issued its decision in three cases concerning the Dutch fiscal unity regime (C-39/13, C-40/13 and C-41/13). The question at hand was whether the denial of a fiscal unity request by the following entities infringes EU law:

1. a German resident parent company with two Dutch resident sister companies; and
2. a Dutch resident parent company with two Dutch resident companies held through two German resident intermediate holding companies.

According to the ECJ, such denial is indeed incompatible with EU law. A fiscal unity can therefore be requested in situations similar as under (1) and (2).

European Tax Law – Dutch dividend tax

Recently, the ECJ answered preliminary questions of the Dutch Supreme Court in two cases concerning dividend withholding tax on distributions by a Dutch company to its Curacao parent company (C-24/12 and C-27/12). In these cases, it was argued that the 8.3% dividend withholding tax levied was incompatible with the free movement of capital under EU law. The ECJ concluded that the levy of 8.3% withholding tax is compatible with EU law, provided that the levy intends to avoid tax evasion in an effective and proportionate manner. The Dutch Supreme Court has to further assess whether this is indeed the case.

Key developments in tax treaties affecting tax law and practice

The following developments occurred with respect to tax treaties concluded by the Netherlands:

- On 10 June 2014, a new bilateral arrangement for the avoidance of double taxation between the Netherlands and Curacao was submitted to the Dutch parliament. It is expected that this new tax arrangement will enter into force as per 1 January 2015.
- The Netherlands has amended its tax treaties with the United Kingdom, Norway, the Czech Republic and Belgium in 2013 and 2014. The amendments have been included in protocols to the relevant tax treaties.
- For the year 2014, the Dutch State Secretary of Finance announced it will start negotiations with the Russian Federation, Bangladesh, Bulgaria, Egypt, the Philippines, Ghana, Morocco, Nigeria, Ukraine, Uzbekistan, Sri Lanka, Uganda, Vietnam, Zambia and Zimbabwe for amending the tax treaty. The amended tax treaties will likely contain information exchange and anti-abuse provisions.
- Malawi has decided to unilaterally cancel its tax treaty with the Netherlands as from 1 January 2014. According to the Malawi authorities, the cancellation is based on the fact that a new treaty will be concluded at short notice. It is our understanding that the Netherlands completed the negotiations with Malawi to conclude this new tax treaty.
- In 2013, the Tax Information Exchange Agreement concluded between the Netherlands and the British Virgin Islands entered into force.
- The ratification of the new tax treaty between the Netherlands with respectively Germany, China and Ethiopia, is still pending.

Attractions for holding companies

As described above, one of the main tax reasons for international companies to own their investments through a Dutch holding company is without any doubt the Dutch participation exemption regime. The broad scope of the Dutch participation exemption regime (e.g.

100% exemption, only a 5% share interest is required, no minimum holding period is required and operating companies generally qualify irrespective of whether such companies are subject to tax), its longstanding history and the Dutch tax ruling practice contribute to an optimal level of certainty and reliability on the application thereof. In addition, the strong tax treaty network of the Netherlands as well as various non-tax related benefits (e.g. the internationally focused economy, the open business climate, the professional corporate services providers' sector and the various bilateral investment treaties of the Netherlands) contribute to the Netherlands being a very attractive jurisdiction for holding companies.

The year ahead

The year ahead is likely to be marked by the following developments:

- further publication of proposed measures within the BEPS framework;
- discussions within the EU of the expected amendment of the EU Parent Subsidiary Directive, pursuant to which the EU Member State of a parent company should tax any payments derived from a hybrid instrument received from a subsidiary in another EU Member State, if such payment is tax deductible in the latter state; and
- possibly the outcome of the investigation announced by the European Commission aimed at determining whether the tax treatment of Starbucks in the Netherlands is in compliance with EU law against prohibited State Aid.

In addition, it is relevant to note that the Dutch State Secretary of Finance explicitly expressed his intention not to propose significant changes to the Dutch corporate income tax system in the next few years. Besides an expected fundamental revision of the personal income tax regime, the focus of the Dutch Government with respect to the corporate income tax system will be to simplify the legislation to reduce administrative burdens and to combat tax evasion and tax fraud.

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Servaas graduated in Tax Law from the University of Leiden in 1998 and obtained a postgraduate LL.M. degree in International Taxation from the International Tax Centre of the University of Leiden in 2004. He is a member of the Dutch Association of Tax advisers (NOB), the International Bar Association (IBA), the International Fiscal Association (IFA) and the European Private Equity & Venture Capital Organisation (EVCA).

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Wendy Moes is an international tax advisor with over 10 years of experience in serving corporate clients. Wendy started her career in 2002 at Ernst & Young Tax Advisers in the general and international tax practice. She joined Hamelink & Van den Tooren at the beginning of 2007, specialising in international taxation, with a special focus on multinationals and investment funds.
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Wendy graduated (*cum laude*) in Tax Economics from Erasmus University in Rotterdam in 2002. She is a member of the International Bar Association (IBA) where she is a National Reporter for the Netherlands during 2013 and 2014 as part of the IBA Taxes Committee.

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